



GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2009 Biennium

Bill #	SB0439	Title:	Nonresident withholding for natural resource royalty payments
Primary Sponsor:	Elliott, Jim	Status:	As Amended in House Committee

- | | | |
|---|--|--|
| <input type="checkbox"/> Significant Local Gov Impact | <input checked="" type="checkbox"/> Needs to be included in HB 2 | <input checked="" type="checkbox"/> Technical Concerns |
| <input type="checkbox"/> Included in the Executive Budget | <input type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

FISCAL SUMMARY

	<u>FY 2008 Difference</u>	<u>FY 2009 Difference</u>	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>
Expenditures:				
General Fund	\$443,130	\$129,726	\$132,969	\$136,293
Revenue:				
General Fund	\$1,497,868	\$2,494,183	\$2,504,611	\$2,504,611
Net Impact-General Fund Balance	<u><u>\$1,054,738</u></u>	<u><u>\$2,364,457</u></u>	<u><u>\$2,371,642</u></u>	<u><u>\$2,368,318</u></u>

Description of fiscal impact:

Royalties that Montana mineral producers pay to mineral rights owners are Montana source income and are subject to Montana income tax whether the recipient is a resident or non-resident. Under current law, mineral producers are required to report royalty payments of more than \$600 to the IRS, but are not required to report them to Montana or to withhold state income tax. Beginning January 1, 2008, this bill would require mineral producers to withhold income tax from mineral royalty payments to individuals, trusts, and business entities who receive more than \$2,000 per year in royalties. Smaller oil and gas producers would be allowed to make an annual report in lieu of withholding.

FISCAL ANALYSIS

Assumptions:

- Under current law, owners of Montana mineral interests pay the income tax they owe on mineral royalties only if they choose to file a Montana income tax return and report their royalty income. This bill would require mineral producers to withhold 6% of mineral royalty payments to taxable parties who they pay \$2,000 or more in royalties per year.

2. The Department of Revenue analyzed 2004 payments to taxable individuals reported by one of the larger oil and gas producers, and compared those payments to Montana income tax returns for 2004. Of these royalty payments,
 - a. 25.5% of taxable royalties were paid to individuals and 74.5% were paid to corporations,
 - b. 92.5% of payments to individuals went to persons who would be subject to withholding under this bill,
 - c. 43.0% of payments to individuals went to persons who did not file Montana income tax returns, and
 - d. 37.4% of payments to individuals went to persons who would be subject to withholding and did not file Montana income tax returns.
3. Of royalties paid to persons who filed income taxes, 6.8% were paid to persons who did not owe Montana income tax.
4. The average marginal tax rate of royalty recipients who filed Montana income tax returns was 6.11%.
5. The percentage of businesses receiving mineral royalties that pay taxes owed on them is unknown. To avoid over-estimating the impact of this bill, it is assumed to be high, at 95%. All business royalty recipients are assumed to receive at least \$2,000 in royalties per year, but half of royalties paid to business are assumed to be paid by a business to itself (i.e. mineral producers who are also mineral rights owners paying royalties to themselves.) The percentage of business royalty recipients who do not owe tax is assumed to be the same as for individuals, 6.8%.
6. This bill would allow oil and gas producers who produce less than 100,000 barrels of oil and 500 million cubic feet of gas to provide an annual statement of royalties paid instead of withholding. Over the last twelve quarters, oil and gas producers who were above the production threshold paid 90.6% of taxable oil and gas royalties.
7. The percentages in assumptions 2 through 5 are assumed to hold for all mineral royalties. Thus, under this bill,
 - a. income taxes would be withheld on 92.5% of the 25.5% of mineral royalties paid to individuals, and on 50% of the 74.5% of mineral royalties paid to businesses. In total, taxes would be withheld on 60.8% ($92.5\% \times 25.5\% + 50\% \times 74.5\%$) of taxable royalties, with 38.8% of withholding from individuals ($92.5\% \times 25.5\% / 60.8\%$) and 61.3% from businesses ($50\% \times 74.5\% / 60.8\%$),
 - b. 18.75% ($38.8\% \times 37.4\% / 92.5\% + 61.3\% \times 5\%$) of taxes owed and withheld would not have been paid without this bill,
 - c. 6.8% of taxes withheld would be refunded, and
 - d. taxpayers who have tax withheld would owe additional taxes equal to 0.1% of taxes withheld ($(6.11\% - 6\%) \times (100\% - 6.5\%)$).
8. Taxable royalties were 11.8% of gross value reported on oil and gas tax returns for 2001 through 2005.
9. The gross value of oil and gas production will be \$2,795,396,000 in FY 2008 and \$2,492,155,000 each year in FY 2009 through FY 2010 (HJR 2).
10. Taxable oil and gas royalties paid by producers subject to withholding will be \$298,850,196 in FY 2008 ($90.6\% \times 11.8\% \times \$2,795,396,000$) and \$266,431,307 each year in FY 2009 through FY 2010 ($90.6\% \times 11.8\% \times \$2,492,155,000$).
11. Non-tribal coal production will be 37,567,700 tons in FY 2008 and 36,411,700 tons per year in FY 2009 through FY 2011 (HJR 2 coal severance tax estimate). The market price will be \$10.021523 per ton (HJR 2 federal mineral royalties estimate), so that the gross value of production (price times production) will be \$376,485,570 in FY 2008 and \$364,900,689 each year in FY 2009 through FY 2011.
12. Royalty rates average 12.5%. Total coal royalties will be \$47,060,696 in FY 2008 ($12.5\% \times \$376,485,570$) and \$45,612,586 per year in FY 2009 through FY 2011 ($12.5\% \times \$364,900,689$). State and federal coal royalties will be \$36,033,403 in FY 2008 and \$29,610,173 per year in FY 2009 through FY 2010 (HJR 2 school trust and federal mineral royalties estimates).

13. Taxable coal royalties will be \$11,027,293 in FY 2008 (\$47,060,696 - \$36,033,403) and \$16,002,413 per year in FY 2009 through FY 2010 (\$45,612,586 - \$29,610,173).
14. The gross value of production from metal mines will be \$1,024,764,685 in FY 2008 and \$880,261,620 per year in FY 2009 through FY 2010. Total metal mine royalties will be \$128,095,586 in FY 2008 (12.5% x \$1,024,764,685) and \$110,032,703 per year in FY 2009 through 2011 (12.5% x \$880,261,620). There are no state or federal metal mine royalties (HJR 2 school trust and federal mineral royalties estimates) so that all of these royalties are private.
15. Total taxable royalties paid by producers subject to withholding will be \$437,973,075 in FY 2008 (\$298,850,196 + \$11,027,293 + \$128,095,586) and \$392,466,423 per year in FY 2009 through FY 2011 (\$266,431,307 + \$16,002,413 + \$110,032,703).
16. Withholding will begin in January 2008, half way through FY 2008. Withholding on royalty payments will be \$7,988,629 in FY 2008 ($\frac{1}{2} \times 6\% \times 60.8\% \times \$437,973,075$) and \$14,317,175 per year in FY 2009 through FY 2011 ($6\% \times 60.8\% \times \$392,466,423$).
17. Beginning in FY 2009, when taxpayers who had tax withheld file their returns, they will receive refunds of 6.8% of tax withheld over the previous calendar year and make additional payments of 0.1% of tax withheld. Net collections will be \$7,988,629 in FY 2008, \$13,302,311 in FY 2009 ($\$14,317,175 - 6.7\% \times (\$7,988,629 + \$14,317,175/2)$), and \$13,357,924 per year in FY 2010 and FY 2011 ($\$14,317,175 \times (100\% - 6.7\%)$).
18. The net increase in general fund revenue would be \$1,497,868 in FY 2008 ($18.75\% \times \$7,988,629$), \$2,494,183 in FY 2009 ($18.75\% \times \$13,302,311$), and \$2,504,611 per year in FY 2010 and FY 2011 ($18.75\% \times \$13,357,924$).
19. The Department of Revenue would need to add a new module to its data processing system at a cost of \$300,000 in FY 2008 and with testing costs of \$1,213 per year. Processing and auditing additional withholding and income tax returns would require one additional auditor and one additional administrative support position, with personal service costs of \$103,923 per year in FY 2008 and FY 2009, increasing by 2.5% in FY 2010 and FY 2011. Set up costs for these positions would be \$11,800 in FY 2008. Operating costs would be \$21,322 in FY 2008 and \$22,218 in FY 2009, increasing by 2.5% in later years. Creating a new withholding form would have operating costs of \$2,500 in FY 2008, and annual costs for mailing forms of \$2,372 in FY 2008 and FY 2009, increasing by 2.5% in FY 2010 and FY 2011.

	<u>FY 2008 Difference</u>	<u>FY 2009 Difference</u>	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>
<u>Fiscal Impact:</u>				
FTE	2.00	2.00	2.00	2.00
<u>Expenditures:</u>				
Personal Services	\$103,923	\$103,923	\$106,521	\$109,184
Operating Expenses	\$327,407	\$25,803	\$26,448	\$27,109
Equipment	\$11,800	\$0	\$0	\$0
TOTAL Expenditures	\$443,130	\$129,726	\$132,969	\$136,293
<u>Funding of Expenditures:</u>				
General Fund (01)	\$443,130	\$129,726	\$132,969	\$136,293
TOTAL Funding of Exp.	\$443,130	\$129,726	\$132,969	\$136,293
<u>Revenues:</u>				
General Fund (01)	\$1,497,868	\$2,494,183	\$2,504,611	\$2,504,611
TOTAL Revenues	\$1,497,868	\$2,494,183	\$2,504,611	\$2,504,611
<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>				
General Fund (01)	\$1,054,738	\$2,364,457	\$2,371,642	\$2,368,318

Long-Range Impacts:

1. The additional revenue from this bill will vary over time depending on mineral production and prices.

Technical Notes:

1. Section 4(2)A of the bill as amended, exempts from withholding “a remitter that produces less than 100,000 barrels of oil and less than 500 million cubic feet of gas annually.” Section 4(4) gives the Department of Revenue authority to establish minimum royalty amounts subject to withholding for producers of other minerals. This fiscal note assumes that any thresholds established for producers of other minerals will have a negligible impact on revenue. It also assumes that any possible ambiguities, such as thresholds for a company producing both coal and natural gas, will be resolved through the rulemaking process.

*Sponsor's Initials*_____
*Date*_____
*Budget Director's Initials*_____
Date